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## To Regain Confidence

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There has been much confusion and uncertainty among investors and in Washington about the economy and the stock market, and about what to do in response to a seemingly significant loss of confidence in our system. Much of the focus has been on accounting and corporate governance. These issues are important, but I think the restoration of confidence and the establishment of sound fundamentals going forward require a much broader focus.

To address accounting and corporate governance first: Clearly reforms are needed to deal with the systemic issues revealed by the recent spate of corporate problems, as are specific enforcement actions where appropriate. The accounting and corporate governance bill passed recently by the Senate seems to me on the whole sensible and responsive to these needs. Similarly, the New York Stock Exchange has issued thoughtful proposals on corporate governance. Expensing of stock options is, in my view, worth serious consideration, though practical problems such as valuation need to be resolved. And the conflicts between research and investment banking need a dispositive, industry-wide solution.

These accounting and corporate governance problems developed over time -- as seems to happen after extended good times -- but only really came to the fore during the past year. From the time the magnitude of the problems became clear, the need was for a response that was energetic, effective and as rapid as possible. But that response -- both in regulatory and legislative changes and in enforcement -- should be balanced and appropriate. Our accounting and corporate governance systems have great strengths -- in allowing for decisive management decisions, rapid change and agility, experimentation and risk taking -- and those strengths should not be unwisely eroded.

Having said that, these accounting and corporate governance issues -- though very important -- are only part of a much broader question of how to best promote confidence and strong fundamentals, for the short and the long term.

That was exactly the question the new administration faced in the beginning of 1993, and the strategy then put in place contributed centrally to the remarkably strong economic conditions and sound economic fundamentals for the balance of the 1990s. Unemployment fell from over 7 percent to 4 percent and was under 5 percent for 40 consecutive months; private investment in productive equipment grew at double-digit rates for eight years; annual productivity growth more than doubled by the end of the period; inflation was low; GDP growth averaged roughly 4 percent per annum, and 20 million new private-sector jobs were created. Moreover, instead of the huge 10-year deficits projected by the Office of Management and Budget at the end of 1992, deficits were reduced and in time surpluses began.

Certain imbalances did develop -- for example, the levels of consumer and corporate debt, the level of the stock market, and excess capacity -- as they always do after extended good times, and an adjustment period was inevitable. How difficult that period was going to be would be affected by many factors, very much including the actions of government. Also, the legacy of the 1990s provided

strong fundamentals to ameliorate this adjustment, e.g., a large fiscal surplus, strong productivity growth, low unemployment, more open markets around the world and a healthy banking system.

In my view, we need to restore the sound, broad-based strategy that was so central to the prosperity of the '90s. More specifically, I would focus especially on the following:

1) Virtually the entire \$5.6 trillion surplus projected by the nonpartisan Congressional Budget Office in January 2001, including \$2.5 trillion of Social Security surplus, has now been dissipated. I wrote when last May's 10-year tax cuts were being debated that their direct cost -- later estimated by the CBO as \$1.7 trillion including debt service -- and even more important, their indirect cost in undermining political cohesion around fiscal discipline, threatened the federal government's long-term fiscal position. And that is precisely what has happened.

Long-term fiscal discipline and a sound long-term fiscal position contribute substantially, over time but also in the short term, to lower interest rates, increased consumer and business confidence, and to attracting much-needed capital from abroad to our savings-deficient country. In addition, a sound long-term fiscal position would far better enable us to meet our long-term Social Security and Medicare commitments.

The portion of the 10-year tax cut that occurred in the short-term may well serve a useful expansionary purpose at a time of economic weakness. But the great preponderance of this tax cut occurs in outer years. Moreover, nobody is talking about a tax increase; the question is whether the cuts enacted for later years should be canceled. In my view, all matters pertaining to taxes and spending should be on the table, with a commitment to reestablishing a sound long-term fiscal position for the federal government.

2) Trade liberalization and our own open markets contributed greatly to our economic well-being during the 1990s, and are critically important looking forward. The president should be given trade promotion authority, and the recently adopted steel tariffs and agricultural subsidies -- which present such a threat to global trade liberalization and to business confidence in the outcome of the struggle over continued globalization -- should be corrected. Also -- a related matter -- we should be prepared to engage in and lead an effective and sensible response to financial crisis abroad when our interests can be affected.

3) Budgeting priorities should heavily emphasize preparing our future workforce to be competitively productive in the global economy, including improving our public school system and equipping the poor to join the economic mainstream.

Finally, we must deal effectively -- building on the strong response to the terrible attack of Sept. 11 -- with the immensely complex challenges of terrorism and geopolitical instability that are of enormous importance to our economy as well as to our national security.

Much of this is difficult, substantively and politically, but the willingness to deal with exceedingly difficult public issues was central to our economic well-being in the '90s and is centrally important today and for the years and decades ahead.

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